TESTIMONY OF
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"DISMANTLING THE FINANCIAL INFRASTRUCTURE OF GLOBAL TERRORISM"

BEFORE THE COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES
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Chairman Oxley, Ranking Member LaFalce and Members of the Committee:

I am Marc E. Lackritz, the President of Securities Industry Association.[1] I am pleased to appear before you on behalf of SIA to testify about strengthening the means to cut off the financial activities of potential terrorists.

At the outset, I wish to strongly commend the Committee for holding hearings on steps that can be taken to detect and disrupt the financial activities around the globe that support and advance terrorism. We strongly support this effort. We stand ready to work with Congress and the regulators to fashion a response to address how our system was abused.

I also want to take this opportunity to express the very deep appreciation of everyone in the U.S. securities industry for the heroic firemen, policemen and other rescue workers who have made unimaginable sacrifices, including their lives in far too many instances, trying to save the lives of others. At this dark moment in America's history, these valiant men and women have been an inspiration and a model of valor that no American should ever forget. The atrocities of September 11 also inflicted a terrible toll on the securities industry. We will always try to honor

[1] SIA represents the shared interests of nearly 700 securities firms. SIA member-firms (including investment banks, broker-dealers and mutual fund companies) are active in all phases of corporate and public finance. The U.S. securities industry manages the accounts of nearly 80 million investors directly and indirectly through corporate, thrift, and pension plans. In the year 2000, the industry generated $314 billion of revenue directly in the U.S. economy. Securities firms employ over 700,000 individuals in the U.S.

the memories of the many innocent people in our industry, husbands and wives, fathers and mothers, friends and colleagues, whom we lost on that awful day.

While that day was a grievous one for our nation and our business, the securities industry has shown remarkable resilience, reopening the bond markets two days after the attacks and the equity markets the following Monday. We handled record trading volumes on both the New York Stock Exchange and the NASDAQ in the first trading session after the attacks. Many of the firms that were devastated by the attacks have rapidly moved to find alternate office space and resume business. Many unaffected firms have been extremely generous, offering office space, systems support and back office resources to the impacted firms. We have pulled together magnificently in this difficult time, and I have never been prouder to represent this industry.

But we react to this primarily as Americans. We now face a grave challenge to secure the safety of our families, our peace of mind, the productivity of our economy, and our values as a free people in the face of a barbaric and ruthless enemy. As President Bush has stated, we must meet that challenge on many levels and in many ways, from military action and diplomacy to tracking and disabling financial networks that support terrorism. While the struggle ahead will require patience, dedication and courage, I have no doubt that our nation will prevail, and will emerge from our war on terrorism victorious and stronger than ever. Likewise, our economy and our markets will overcome the blows that were inflicted on September 11, and will continue to be engines of opportunity and growth for the United States and the rest of the world.

SIA and our member-firms have long been strong supporters of the government's anti-money laundering efforts. Securities firms presently are subject to a number of statutory and regulatory requirements that enable the federal government to better identify and combat money laundering. Since public trust and confidence in our industry and marketplace is our most

important asset, we are fully committed to completely eliminating any possible money laundering from the securities industry. Many of the existing practices presently employed within the industry demonstrate the industry's commitment. For example, the widespread practice at brokerage firms of not accepting cash or severely limiting the deposit of cash and cash-like monetary instruments sets the securities industry apart from other financial institutions. Further, many firms—including those presently under no legal obligation to do so—report suspicious or potentially suspicious transactions relevant to possible violations of law or regulation.

In order to provide the Committee with an understanding of the anti-money laundering obligations of the securities industry, let me first address the statutes and regulations that apply to broker-dealers.

A. The Anti-Money Laundering Statutes and Regulations Applicable to the Securities Industry

Since 1970, broker-dealers have been subject to certain federal anti-money laundering laws imposing reporting and record keeping requirements. The principal anti-money laundering rules for a broker-dealer are found in the Bank Secrecy Act ("BSA"). Like banks, securities firms, since 1970, have been required to report currency transactions in excess of $10,000 on a Currency Transaction Report ("CTR"). Similarly, they have been required to file reports relating to the physical transportation of currency or bearer instruments in amounts over $10,000 into or outside of the United States on a Currency or Monetary Instrument Transportation Report ("CMIR").

Over time, the U.S. Treasury Department ("Treasury") has also adopted other record keeping rules, which have varying degrees of relevance to the securities industry. For example,

in 1994, the BSA was amended to prohibit financial institutions from selling money orders, or bank, cashier's or traveler's checks for more than $3,000 in currency unless the institution first verifies and records the identity of the purchaser. Even though most broker-dealers do not engage in cash transactions and do not sell these types of instruments, these responsibilities are still applicable to the securities industry. In 1995, Treasury promulgated a "Joint Rule" and a related "Travel Rule" requiring all financial institutions to maintain certain information regarding funds transfers of $3,000 or more, *see* 31 C.F.R. § 103.33(e) & (f) (2000), and to include the required information in the transmittal of funds. *See* 31 C.F.R. §§ 103.33(e)(f) and (g) (2000).

Since 1986, broker dealers, like other financial institutions, have been subject to the criminal provisions of the Money Laundering Control Act of 1986, P.L. 99-570 ("MLCA"). Among other things, the MLCA established two anti-money laundering criminal statutes that for the first time, made money laundering a crime in and of itself. *See* 18 U.S.C. §§ 1956 and 1957 (2000). The MLCA also added certain provisions to the BSA, which were also applicable to brokerage firms, including adding a specific prohibition against "structuring" transactions to avoid the impact of the BSA's reporting thresholds.

In April 1996, the Treasury Department promulgated a Suspicious Activity Report ("SAR") filing requirement for banks to report suspicious activities relative to possible money laundering. At that time, Treasury indicated that it would be adopting SAR reports for broker-dealers in the future. To advance this regulation, the securities industry worked with Treasury at that time to provide input so that any SAR reporting obligation for broker-dealers took into account the differences between the securities business and the banking industry, as well as the various differences within securities firms. Concurrently with Treasury's adoption of this SAR

regulation for banks, the bank regulatory agencies adopted a parallel requirement requiring banks to file SARs for both money laundering and all suspected federal criminal violations.

Although Treasury had not yet proposed SAR reporting requirements for broker-dealers, in 1996, the federal bank regulatory agencies adopted regulations extending their own rules to the subsidiaries of bank holding companies, including broker-dealers, and requiring these broker-dealers to file reports of suspicious activity. Since that time, all broker-dealers that are subsidiaries of bank holding companies have been required to file SARs. It should be noted that since the adoption of the SAR requirement, the number of firms that are now subsidiaries of bank holding companies has dramatically increased. Thus, only those broker-dealers that are not subsidiaries of a bank holding company are not currently under any legal requirement to file SARs. However, many of these firms, and in particular the larger firms, file voluntarily, even though they are under no legal obligation to do so.

The SEC and the self-regulatory organizations also have various existing regulations requiring the reporting of securities violations in order to ensure the safety and soundness of securities firms. These include the uniform forms for registration and termination ("U-4s" and "U-5s"), and forms for reporting violations of securities rules ("RE-3s), as well as other forms relating to net capital violations. All broker-dealers, whether a part of a bank holding company or not, are required to file these forms.

In sum, the conduct of broker-dealers, like that of all financial institutions, has since 1970 been governed by the record keeping and reporting requirements of the BSA, and since 1986 by the general prohibitions against money laundering found in sections 1956 and 1957. Broker-dealers that account for the vast majority of client assets within the securities industry have been

filing SARs – because they have been required to as subsidiaries of bank holding companies or filing voluntarily.

Further, securities firms, like banks, are subject to the provisions of the various sanctions programs administered by the Office of Foreign Assets Control ("OFAC"). These include prohibitions against trading with certain identified enemies of the United States, as set forth in various lists prepared by OFAC and other agencies of the government. These also include certain money launderers identified by the government, including members of the Cali cartel and other individuals identified under the Foreign Narcotics Kingpin Designation Act.

B. Industry Practices Relating To Anti-Money Laundering Initiatives

While the securities industry has been subject to the specific rules described above, in an effort to be responsive to concerns about money laundering and to protect their reputations and integrity, many firms have gone beyond these requirements and developed their own anti-money laundering programs. In fact, building upon traditional Know Your Customer practices in the securities industry, and their own regulatory requirements, members of the securities industry have attempted to design for themselves anti-money laundering programs that best suit their businesses and that are consistent with their own regulatory scheme.

Given the variety and complexity of the securities industry today, and the considerable differences among securities firms, it is widely recognized that no one standard or model program is appropriate for all firms industry wide. As Lori Richards, Director of the SEC's Office of Compliance Inspections and Examinations has observed, in describing an appropriate money laundering program for the securities industry, there is no "one-size-fits-all" template. The securities industry is comprised of introducing brokers (historically, smaller firms), clearing

firms (generally, larger, well-capitalized firms), firms that offer customers discount brokerage and prime brokerage services, and firms that provide clients the ability to transact business via the Internet. Some firms service retail customers, others deal primarily with an institutional client base, and others handle both types of customer accounts. Moreover, while large firms are able to facilitate customer trades and transactions involving millions of dollars, other organizations, may operate in a local community and offer limited services with limited capital. A firm's anti-money laundering program must therefore be adjusted to reflect the type of firm involved, the breadth and scope of its customer base, its business and its resources.

Consistent with this approach, most firms on their own initiative have developed a policy of prohibiting or restricting the receipt of currency at the firm. The significance of this policy cannot be overstated. Many of the suspicious transactions reported by banks involve attempts to or actual engaging in transactions in currency. Restricting the acceptability of these cash deposits limits the exposure of broker-dealers to the placement stage of money laundering, *i.e.*, the initial placement of currency into the financial institution. Similarly, broker-dealers have for many years on their own initiative limited the receipt of cash equivalents, such as money orders and traveler's checks. This voluntary procedure was initiated in order to deter individuals who purchase these instruments in exchange for currency at banks, thereby potentially structuring the transaction below the $10,000 reporting threshold, from depositing these instruments at broker-dealers as part of their structuring scheme.

Securities firms also have procedures to know their customer ("KYC"). The concept of KYC in the securities industry has developed largely from existing rules of self-regulatory organizations ("SROs") designed to ensure that a recommended securities transaction is suitable for a particular customer. Since at least the early 1960's, New York Stock Exchange Rule 405

has provided that "each member organization is required ... to ... [u] se due diligence to learn the essential facts relative to every customer, every order, every cash or margin account accepted or carried by such organization and every person holding power of attorney over any account accepted or carried by such organization." The NASD's Conduct Rules, as well as NYSE's Rule 405, generally require that securities firms obtain basic information pertaining to the prospective customer at the time the account is opened, including the customer's name and residence and whether the customer is of legal age. Additionally, for certain types of accounts, securities firms must make reasonable efforts to obtain, prior to the settlement of the initial transaction in the account, "the customer's tax identification or Social Security number, occupation of the customer and name and address of employer, and whether the customer is an associated person of another member."

Moreover, if the customer is a corporation, partnership or other legal entity, the suitability rules generally require that the firm obtain the names of any persons authorized to transact business on behalf of the entity. In addition, under these rules, the account opening documents must be signed by both the registered representative who introduces the account and the member or partner, officer or manager who accepts the account.

As a matter of good business practice, many securities firms go beyond the suitability rules, and seek to obtain additional information, such as the customer's date of birth, telephone number, investment experience and objectives, familial information, and information related to the customer's nationality. Further, at the new account opening stage, most firms use vendor databases to check for background information on their customers in order to assure themselves that there is nothing untoward in the customer's past.

The process of "knowing one's customer" is not concluded once the initial account opening information has been obtained. Even after the account is established, firms, in the normal course of the relationship, continue to build upon the information initially provided by the customer and update their records accordingly.

The efforts of the securities industry do not stop there. Continuing with their voluntary efforts, many firms have adopted procedures for monitoring transactions to prevent and detect money laundering and potential structuring transactions. For example, many firms monitor for the receipt of cashier's checks, in amounts of less than $10,000, since they may evidence potential structuring in violation of the Currency Transaction Reporting Requirements.

Moreover, many firms have gone beyond the attempt to identify structuring of transactions and attempted to design and implement their own software programs to identify more sophisticated patterns of money laundering. In this context, it is important to recognize that because securities firms do not routinely accept cash or cash-equivalents, they are generally only able to identify these types of transactions at the more difficult stage in the money laundering process, that is, the layering or integration stages of money laundering. There is no simple formula for the detection of these types of transactions at this stage in the process and even regulators are unable to provide significant guidance in this area, thus making the process extremely difficult. Nevertheless, many firms, particularly large firms, have developed or are in the process of developing monitoring procedures for wire transfers, again, all on their own initiative.

Increasingly, there has been an overlap developing between the entities or names identified by the various sanctions programs administered by OFAC and various anti-money laundering concerns. Indeed OFAC provides the industry with names of certain terrorists and

drug dealers who represent a threat to our country. Accordingly, members of the industry have incorporated the OFAC rules into these monitoring programs to ensure compliance with both sets of regulations.

Finally, although the broker-dealer SAR rule has not been proposed as yet, many firms on their own have been filing suspicious activity reports on a voluntary basis since the rule was adopted for banks. To do this they have relied on the above-described monitoring procedures, but also on their traditional obligations to know their customers.

In general**,** securities firms with global operations apply the same procedures in foreign countries consistent with the money laundering statutes in those countries.

C. Securities Industry Anti-Money Laundering Initiatives

Historically, the securities industry has been supportive of our government's efforts to combat money laundering. SIA and many securities firms have worked closely with Treasury, the SEC, the federal bank regulatory agencies and members of Congress to assist in these efforts.

Among our most significant efforts has been our work with the Treasury and SEC since 1995 to develop regulations extending the requirement to file Suspicious Activity Reports to broker-dealers, which is one of the items called for by the National Money Laundering Strategy for 2001. Industry representatives have spent hundreds of hours sharing our views on how to implement an effective system for broker-dealers to identify and report suspicious activity. We have given suggestions on the proposed rule, the guidance to accompany the rule, and the SAR form, which we believe should be markedly different from the bank SAR because of the different types of businesses engaged in by the securities industry. During the past, industry

representatives as part of the Bank Secrecy Act Advisory Group have also provided input to Treasury on other rules, such as the Funds Transfer Rules.

At the beginning of this year, we met the new administration's Treasury Department officials to share our views on anti-money laundering compliance in the securities industry. At those meetings, we again emphasized the benefits to be gained from a broker-dealer SAR rule and our support for such a rule. In short, we have long supported the issuance of SARs for broker-dealers, and look forward to working with Treasury and the SEC to help finalize a rule.

We applauded the SEC's announcement earlier this year that it was going to step up its examination of broker-dealers for anti-money laundering compliance. Following that announcement, we shared our views with the SEC and SROs, which will also conduct the examinations, on how these examinations could be most effective. We also met with SEC and SRO examiners on several occasions to help them understand the kinds of anti-money laundering programs that broker-dealers have implemented. We think the SEC's examinations will help the entire industry enhance its compliance efforts, and will continue to work to make these examinations effective.

SIA also worked closely with the staff of Treasury and other agencies to develop the *Guidance on Enhanced Scrutiny for Transactions That May Involve the Proceeds of Foreign Official Corruption* (the "Guidance"), which was issued in January of this year. SIA is supportive of the goals of the Guidance to aid in the identification of transactions by senior foreign political officials that may involve the proceeds of foreign official corruption. We believe industry and government should continue cooperating in this area and focus efforts on compiling a list of "senior foreign political officials" that would be accessible to industry.

SIA has also worked with the Treasury Department's Office of Foreign Assets Control to aid their understanding of the securities industry. In coordination with OFAC, we have implemented certain initiatives to help our member firms be aware of the trading restrictions and asset freezes imposed by OFAC. For instance, we immediately email to our firms and post to our Website any OFAC bulletin or announcement sent to us by OFAC. SIA's Website contains an OFAC page listing OFAC updates, and also includes a link to OFAC's Website.

At the end of last year, SIA met with and submitted comments to the Judicial Review Commission on Foreign Asset Control on the Foreign Narcotics Kingpin Designation Act. The Act prohibits U.S. persons, including U.S. financial institutions, from conducting financial or business transactions with those individuals or entities designated as "Significant Foreign Narcotics Traffickers." Our comments indicated our support of the Kingpin Act and our belief that the application of the sanctions authorized by the legislation will aid government efforts to continue the fight against the international distribution of drugs and other related criminal activity. We also provided the Judicial Review Commission with certain recommendations to improve the current asset blocking scheme under the International Emergency Powers Act.

One other area that SIA has cooperated with government has been on the General Accounting Office's survey of the anti-money laundering compliance in the securities industry. During the past year, in addition to submitting written surveys to GAO, many of our firms have spent much time meeting with GAO staff to aid their understanding of securities industry practice. We understand that GAO's report is due in a few weeks.

Lastly, industry members have long been involved in industry-wide training on anti-money laundering issues. One such effort was the preparation of an anti-money laundering videotape. SIA has implemented many initiatives to educate the industry on money laundering

and OFAC issues. We recently held an anti-money laundering conference at which representatives from the SEC, FinCEN, the Federal Reserve Board, the NASD and OFAC spoke, and an entire session was devoted to OFAC issues. In addition, we send Legal Alerts to our members advising them of current anti-money laundering issues, such as the OFAC requirements, foreign transaction advisories from FinCEN, and the SEC's recently announced examination of anti-money laundering compliance. As previously mentioned, our Website contains a page devoted not only to OFAC but to FinCen issues as well. The website lists OFAC bulletins, FinCEN advisories and other information to help firms comply.

D. Industry's Response to The Terrorist Activity and Suggestions For Improved Public-Private Coordination

I would like to now turn to what our industry is doing in response to the President's September 24th order freezing U.S. assets of and blocking transactions with 27 individuals and organizations. Consistent with our practice and in coordination with OFAC and the SEC, we promptly sent notice of the order to our member-firms, and posted the notice on our Website. We have asked firms to check their records for any relationships or transactions with individuals or organizations named in the order. We have also distributed the list of names identified by the Federal Bureau of Investigations. Many of our firms have received requests from SROs for information on certain trading in securities that occurred before September 11, and they are responding to those requests. Firms are going beyond those requests and examining and looking for unusual trading patterns in equities, fixed income, options and futures in certain industries.

In addition, two days ago many of our firms met in New York to coordinate what they are doing in response to the Executive Order and the other requests from regulators. We have also arranged a meeting tomorrow between our member firms and several regulatory and law

enforcement representatives. The purpose of these meetings is to convey to these agencies what we as an industry are doing, to learn if we can respond more effectively, and to offer additional assistance to the government. As a starting point, we intend to designate individuals from our firms as point persons and to have the agencies designate such persons as well. This will greatly improve communication.

Turning to legislation, SIA is supportive of the need to have anti-money laundering legislation and would welcome any legislative tools, which will enable our members to combat money laundering.

To the extent that any legislation imposes additional due diligence obligations on financial institutions, including securities firms, we believe it is very important to provide flexibility with respect to those requirements. Thus we are supportive of legislation which delegates authority to the Secretary of the Treasury to propose such procedures, through regulation, after consultation with both the SEC and members of the industry.

We also think legislation should help to facilitate communication between broker-dealers and between banks and broker-dealers when they are investigating suspicious activity. Presently, brokerage firms are constrained from sharing with each other or with banks, information they have received which they believe may be suspicious. Since a customer may have accounts at multiple firms, and since money laundering often involves movement of monies between firms, it would facilitate and expedite the fact gathering and analysis leading to the identification of suspicious transactions, if firms could communicate openly between themselves for this limited purpose.

As to suggestions for improved cooperation between government and industry, we support the expansion of the Bank Secrecy Act Advisory Group's mandate to include terrorism

and other issues related to the security of our financial system. Alternatively, we would suggest the creation of a joint industry/government task force to address these issues. We think these issues need to be addressed at all times, not just in times of crises.

One area we would like to highlight where there could be improved coordination between industry and government is in industry's efforts to monitor accounts of senior foreign political officials. Our efforts in this area would be aided greatly if the government provided a list of all such individuals to financial institutions. It is well within the ability of the government to identify these individuals and such a list would also permit industry to focus more of its resources on monitoring accounts, rather than trying to prepare its own list of such persons. Such a list would be similar to those lists issued by OFAC.

On behalf of the Securities Industry Association, I appreciate the opportunity to submit our views on the proposed legislation and hope that they are of assistance to the Committee in reaching its very important goal of improving the government's tools against money laundering and terrorism. We will be available to provide additional comments to the Committee as it considers legislation addressing these critical issues. I am happy to try to respond to any questions the Committee may have.